

FEB 26 11 19 AM '97

Before the  
Federal Communications Commission  
Washington, D.C. 20554

In the Matter of )  
 )  
Amendment of Parts 32 and 64 of the )  
Commission's Rules to Account for ) CC Docket No. 93-251  
Transactions Between Carriers and )  
Their Nonregulated Affiliates )

**ORDER****Adopted: February 19, 1997****Released: February 20, 1997**

By the Commission:

**I. INTRODUCTION**

1. In this Order, we terminate the above-captioned proceeding concerning the amendment of Parts 32 and 64 of our rules to account for transactions between carriers and their nonregulated affiliates.<sup>1</sup> We take this action in light of our adoption of the *Accounting Safeguards Order*<sup>2</sup> which, in amending Parts 32 and 64 of our rules as required by the Telecommunications Act of 1996,<sup>3</sup> also resolved the issues raised in the *Affiliate Transactions Notice*.

**II. BACKGROUND**

2. In 1987, the Commission adopted federal accounting requirements for transactions between carriers and their nonregulated affiliates as part of a comprehensive

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<sup>1</sup> Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd 8071 (1993) (*Affiliate Transactions Notice*).

<sup>2</sup> Accounting Safeguards Under the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-150, FCC 96-490 (rel. December 24, 1996) (*Accounting Safeguards Order*).

<sup>3</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. We will refer to the Communications Act of 1934, as amended, as "the Act."

effort to improve the safeguards against misallocation of costs.<sup>4</sup> The affiliate transactions rules adopted in the *Joint Cost Proceeding* distinguished between asset transfers and the provision of services among carriers and their nonregulated affiliates.<sup>5</sup> The affiliate transactions rules also established valuation methods for asset transfers,<sup>6</sup> valuation methods for the provision of services,<sup>7</sup> and standards governing the methods carriers employ to apportion their costs between regulated telephone services and nonregulated activities.<sup>8</sup>

3. In 1993, the Commission released a Notice of Proposed Rulemaking reevaluating our affiliate transactions rules in light of our belief that the mix of valuation methods established by the *Joint Cost Proceeding* might "not be optimal for protecting ratepayers against cross-subsidization."<sup>9</sup> The *Affiliate Transactions Notice* presented tentative conclusions and proposed modifications to our affiliate transactions rules to prevent subsidization of nonregulated services by ratepayers, i.e., to prevent improper allocation of costs to regulated services. In particular, the *Affiliate Transactions Notice* questioned the efficacy of the prevailing price valuation method and proposed to prescribe identical valuation methods for affiliate transactions involving assets and services.

4. Before any further action was taken by the Commission regarding CC Docket No. 93-251, the 1996 Act became law. The intent of the 1996 Act is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."<sup>10</sup> The Act

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<sup>4</sup> Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298 (*Joint Cost Order*), recon., 2 FCC Rcd 6283 (1987) (*Joint Cost Reconsideration Order*), further recon., 3 FCC Rcd 6701 (1988) (*Further Reconsideration Order*), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

<sup>5</sup> See *Joint Cost Order*, 2 FCC Rcd at 1336, para. 294; *Joint Cost Reconsideration Order*, 2 FCC Rcd at 6293, para. 91.

<sup>6</sup> See *Joint Cost Order*, 2 FCC Rcd at 1336, paras. 295-98; *Joint Cost Reconsideration Order*, 2 FCC Rcd at 6295-96, paras. 109-20; 47 C.F.R. § 32.27 (b)-(c).

<sup>7</sup> See *Joint Cost Order*, 2 FCC Rcd at 1336, para. 299; *Joint Cost Reconsideration Order*, 2 FCC Rcd at 6297-98, paras. 130-35; 47 C.F.R. § 32.27(d).

<sup>8</sup> See *Joint Cost Order*, 2 FCC Rcd at 1318, para. 161; 47 C.F.R. § 64.901.

<sup>9</sup> *Affiliate Transactions Notice*, 8 FCC Rcd at 8076, para. 9.

<sup>10</sup> Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) (Joint Explanatory Statement).

imposes upon the Commission an obligation to prevent cross-subsidization, thus ensuring that those using regulated services are not burdened with the costs and risks of their service providers' nonregulated, competitive ventures.

5. The Act permits the Bell Operating Companies ("BOCs") to engage in previously proscribed activities if the BOCs satisfy certain conditions that are intended to prevent the BOCs from recovering costs of their new ventures from subscribers to local exchange and exchange access services and from discriminating against their competitors in these new markets.<sup>11</sup> The Act places similar conditions on other incumbent local exchange carriers electing to enter or continue to participate in certain markets.<sup>12</sup> Sections 260 and 271 through 276 outline the conditions under which incumbent local exchange carriers may offer telemessaging and alarm monitoring services and under which the BOCs may manufacture and provide telecommunications equipment, may manufacture customer premises equipment ("CPE"), and may offer interLATA telecommunications, information, electronic publishing and payphone services. The Act requires that many of these services must be provided through separate affiliates.<sup>13</sup>

6. In CC Docket No. 96-150 we offered tentative conclusions and proposals regarding the amendments to Parts 32 and 64 of our rules required to satisfy the cost-misallocation prohibitions in sections 260 and 271 through 276 of the Act. Many of these tentative conclusions and proposals had first appeared in the *Affiliate Transactions Notice*. We subsequently adopted the *Accounting Safeguards Order*, which prescribes the way incumbent local exchange carriers, including the BOCs, must account for transactions with affiliates involving both regulated telecommunications services and nonregulated services, including previously proscribed activities, to ensure compliance with the Act. In particular,

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<sup>11</sup> The Modification of Final Judgment ("MFJ") originally prohibited the BOCs from providing information services, providing interLATA services, or manufacturing and selling telecommunications equipment or manufacturing customer premises equipment. United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983), vacated sub nom. United States v. Western Elec. Co., slip op. CA 82-0192 (D.D.C. Apr. 11, 1996). The reasoning behind these prohibitions in the MFJ was that the BOCs could leverage their market power in the exchange and exchange access service market to impede competition in the interLATA services, manufacturing, and information services markets. The information services restriction was modified in 1987 to allow BOCs to provide voice messaging services and to transmit information services generated by others. See United States v. Western Elec. Co., 673 F.Supp. 525 (D.D.C. 1987); United States v. Western Elec. Co., 714 F.Supp. 1 (D.D.C. 1988); United States v. Western Elec. Co., 767 F.Supp. 308 (D.D.C. 1991). In 1991, the restriction on BOC ownership of content-based information services was lifted. United States v. Western Elec. Co., 767 F.Supp. 308 (D.D.C. 1991), stay vacated, United States v. Western Elec. Co., 1991-2 Trade Cases (CCH) ¶ 69,610 (D.C. Cir. 1991).

<sup>12</sup> See, e.g., 47 U.S.C. §§ 260(a), 275(b).

<sup>13</sup> See, e.g., id. §§ 271(a)(2), 274(a).

the *Accounting Safeguards Order* adopted modifications to the prevailing price valuation method<sup>14</sup> and established identical valuation methods for affiliate transactions involving assets and services.<sup>15</sup> In implementing the prohibitions on cost-misallocation in sections 260 and 271 through 276 of the Act, the *Accounting Safeguards Order* also directly addressed many other issues first raised in the *Affiliate Transactions Notice* including compliance with generally accepted accounting principles ("GAAP"), the appropriate return component for affiliate transactions, and estimates of fair market value.<sup>16</sup>

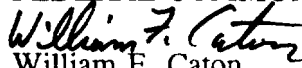
### III. DISCUSSION

7. The *Accounting Safeguards Order* amended Parts 32 and 64 of our rules to meet the Act's prohibitions of cost-misallocation and to account for the ability of incumbent local exchange carriers to engage in previously proscribed activities. The amendments to our affiliate transactions rules prescribed by the *Accounting Safeguards Order* apply to all affiliate transactions between regulated telecommunications carriers and their nonregulated affiliates.<sup>17</sup> Because in amending Parts 32 and 64 of our rules as required by the Act the *Accounting Safeguards Order* also resolved the issues raised in the *Affiliate Transactions Notice*, the issues raised in the *Affiliate Transactions Notice* are now moot. Accordingly, we terminate as moot CC Docket No. 93-251.

### IV. ORDERING CLAUSE

8. Accordingly, IT IS ORDERED that, pursuant to sections 4(i), 4(j), 201-205, 218, 220, 260, 271-76, 303(r), 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201-205, 218, 220, 260, 271-176, 303(r), 403, CC Docket No. 93-251 IS TERMINATED as moot.

FEDERAL COMMUNICATIONS COMMISSION

  
William F. Caton  
Acting Secretary

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<sup>14</sup> Accounting Safeguards Order at paras. 125-137.

<sup>15</sup> Id. at paras. 138-148.

<sup>16</sup> Id. at paras. 149-154, 160-170.

<sup>17</sup> Id. at para. 109.